

**BILL #** HB 2341

**TITLE:** tax subtraction; net operating loss

**SPONSOR:** Huffman

**STATUS:** As Introduced

**PREPARED BY:** Brian Cary

## **FISCAL ANALYSIS**

### **Description**

The bill would increase the net operating loss (NOL) carry forward period for corporate taxpayers from 5 years to 20 years.

### **Estimated Impact**

The fiscal impact of the bill cannot be determined with certainty. The Department of Revenue (DOR) estimates the revenue loss to the state from the bill to be in the range of \$20 million to \$50 million per fiscal year. It is very likely that the amount of future tax liability that could be offset by NOL would increase if the carry forward period is extended from 5 to 20 years. However, specific estimates of NOL by tax year cannot be made from Arizona tax return data, so the timing and magnitude of potential NOL carry forward and related revenue losses cannot be accurately predicted.

### **Analysis**

There is uncertainty about the bill's impact due to the limitations of the data available to DOR. In recent tax years, out of a total of 50,000 to 55,000 Arizona corporate income tax returns per tax year, approximately 12,000 per year have reported NOL. In tax year 2002, the last for which statistics are reasonably complete, 12,255 tax returns reported \$12.817 billion in NOL. The total NOL for a taxpayer is a single line item on its tax return and is not broken down by the years when the losses were incurred.

DOR estimated the amount of Arizona taxable income offset by NOL in tax year 2002 to be \$979 million. In order to calculate the amount of tax revenue lost to the current 5-year NOL carry forward provision, DOR applied the 6.968% corporate income tax rate, which yielded an estimated NOL tax revenue impact of \$(68.2) million. The estimated impact ranged from a low of \$(30) million to a high of \$(117) million between tax years 1995 and 2002.

In many cases, a taxpayer claiming NOL from prior years has insufficient income to fully utilize those losses, so much of the NOL never offsets future income and the potential revenue loss is reduced. However, since a taxpayer is required only to report its total NOL from the previous 5 years as one amount, the amount of potential NOL from any single tax year cannot be determined.

While DOR states that the impact of a 20-year NOL carry forward cannot be accurately quantified, it estimates the cost to the General Fund would fall in the range of \$(20) million to \$(50) million per year. If the NOL carry forward period is extended from 5 years to 20 years, then the ability to offset prior losses against future income would be enhanced significantly. For example, a company could incur a \$100 million NOL in tax year 1 and then report positive income of \$5 million per year in tax years 2 through 21. Under current law, the taxpayer would only be able to offset \$25 million of its taxable income in tax years 2 through 6 before the carry forward period from year 1 expired. With the 20-year carry forward period provided by the bill, the taxpayer would be able to offset all \$100 million of its taxable income in tax years 2 through 21. DOR notes that the value of a taxpayer's NOL is limited by the amount of tax liability that can be offset, so is unlikely that most taxpayers could use their NOL as fully as the one cited in this example.

If NOL from a 5-year carry forward period is already offsetting a corporation's tax liabilities, then an extension to a 20-year carry forward period would have no net revenue impact. Conversely, if a corporation had ample and consistent income over time to fully apply relatively modest losses from prior years, extending the carry forward period would not significantly reduce its cumulative tax liabilities. It may choose to spread its NOL over a larger number of future tax years, which could potentially reduce the volatility of corporate income tax collections.

DOR indicates that the department's audit staff would incur an additional administrative burden, since it would have to review an additional 15 years of NOL history for corporations and their subsidiaries. Corporate taxpayers would have to retain their records for the additional years if they were to use them for Arizona income tax purposes.

A 20-year NOL carry forward period would make Arizona more attractive to corporations when compared to other states with shorter carry forward periods. Conforming to the 20-year federal carry forward period would also make it easier for some corporations to prepare their Arizona tax returns. However, DOR indicated that the bill could make tax filings more complex for a consolidated group of businesses that files a single federal tax return but files as separate groups at the state level.

### **Local Government Impact**

Each year cities and towns receive an amount equal to 15% of income tax collections from two years prior. If the bill's state revenue impact were to be \$(20) million in FY 2007 and in FY 2008, local government distributions would decline by \$(1.5) million in FY 2009 and in FY 2010.

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